STATE OF MICHIGAN

IN THE SUPREME COURT

Appeal from the Court of Appeals
Court of Appeals No. 237873

MICHIGAN ELECTRIC COOPERATIVE ASSOCIATION, et al.,

Appellants,

v

MICHIGAN PUBLIC SERVICE COMMISSION,

Appellee.

Supreme Court No. 125954
Court of Appeals No. 237873

In the matter of the approval of a code of conduct for CONSUMERS ENERGY COMPANY and THE DETROIT EDISON COMPANY

MPSC Case No. U-12134

THE DETROIT EDISON COMPANY,

Appellant,

v

MICHIGAN PUBLIC SERVICE COMMISSION, et al,

Appellee.

Supreme Court No. 125950
Court of Appeals No. 237872

CONSUMERS ENERGY COMPANY,

Appellant,

v

MICHIGAN PUBLIC SERVICE COMMISSION, et al,

Appellee.

Supreme Court No. 125955
Court of Appeals No. 237874

BRIEF ON APPEAL - APPELLANTS MICHIGAN ELECTRIC COOPERATIVE ASSOCIATION *ET AL*

ORAL ARGUMENT REQUESTED

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TABLE OF CONTENTS

INDEX OF AUTHORITIES

Cases

Statutes

Other Authorities

Rules

Constitutional Provisions

STATEMENT OF THE BASIS OF JURISDICTION

Pursuant to MCR 7.301(A)(2) and MCR 7.302(G)(3), this Court has jurisdiction over this matter pursuant to its November 5, 2004 Order granting leave to appeal in consolidated case numbers 125950, 125954, and 125955. The appeal is from the Court of Appeals' March 2, 2004 decision in consolidated case numbers 237872, 237873, and 237874.

QUESTION PRESENTED

ARE THE MICHIGAN PUBLIC SERVICE COMMISSION'S DECEMBER 2000 AND OCTOBER 2001 ORDERS UNLAWFUL BECAUSE THEY WERE NOT PROMULGATED IN CONFORMITY WITH THE ADMINISTRATIVE PROCEDURES ACT'S RULEMAKING PROVISIONS, AND NO STATUTORY EXCEPTIONS TO THE RULEMAKING REQUIREMENTS APPLY?

Appellant MECA answers "yes."

Appellee MPSC would answer "no."

The Court of Appeals answered "no."

INTRODUCTION

This case arises out of a series of Michigan Public Service Commission ("MPSC") orders that have ever widening consequences for the electric industry. In the late 1990s, two electric utilities, The Detroit Edison Company ("Detroit Edison") and Consumers Energy Company ("Consumers Energy" or "Consumers"), began participating in voluntary retail open access programs that allow customers to purchase electric power from third party suppliers, generally referred to as "alternative electric suppliers."[1]

In conjunction with the retail open access programs, in the late 1990's, the MPSC had been engaged in a contested case proceeding to formulate a voluntary code of conduct for the two involved regulated utilities, Consumers Energy and Detroit Edison. After the Michigan Legislature passed the Customer Choice and Electricity Reliability Act ("Act 141"), 2000 PA 141, the MPSC took the extraordinary step of using the existing contested case proceeding to create and apply a uniform code of conduct to all electric utilities and alternative electric suppliers and their affiliates. The resulting code of conduct, which imposes burdensome continuing obligations upon the entire electric industry, should have been created through formal rulemaking, rather than a contested case proceeding. If proper rulemaking procedures had been followed, all affected entities, as well as members of the public, would have been afforded meaningful participation.

In this case, Appellants ask this Court to do no more than apply its own precedent and enforce the provisions of the Administrative Procedures Act (the "APA"), 1969 PA 306, MCL 24.201 *et seq.*, which require the MPSC to create rules of general applicability through the

[1] Under retail open access, the alternative electric supplier provides electricity (generation service) to retail customers over the participating utility's wires (distribution service).

APA's formal rulemaking requirements rather than through "contested case" proceedings. While this request is relatively modest, the decision in this case has far-reaching consequences for the conduct of administrative agencies in Michigan. If the MPSC's blatant disregard for APA procedures is permitted to stand, this Court will have allowed the absolute evisceration of the protections purposefully provided in the APA's rulemaking standards. Contested cases are intended to be used only to adjudicate specific factual situations applicable to specific parties. If this Court fails to correct the Court of Appeals' error, administrative agencies will be able to avoid rulemaking procedures and affect entire industries simply by calling a proceeding a "contested case." This Court should not permit administrative rulemaking to devolve in such a manner, and should eliminate the confusion caused by the Court of Appeals' inconsistent decisions in this area by clarifying the manner in which the requirements of the APA should be applied to agency action.

This brief is filed in response to this Court's order granting Appellants' applications for leave to appeal and directing the parties to brief the issue of whether the MPSC's orders creating the code of conduct "are unlawful because they were not promulgated in conformity with the rule-making provisions of the Administrative Procedures Act, MCL 24.201 *et seq.*" (Supreme Court Order, Appellants' Joint Appendix at 244a). The answer to this question should be a resounding "yes."

STATEMENT OF FACTS

A. Description Of MECA And Its Member Distribution Cooperatives.

The Michigan Electric Cooperative Association ("MECA") is a statewide association representing the collective interests of Michigan's rural electric cooperatives. With the exception of one association member, the cooperatives are consumer owned retail electric utilities regulated by the MPSC.[2] The number of customers served by the cooperatives ranges from a low of approximately 4,500 to a high of approximately 120,000. MECA's distribution cooperative members serve in 58 of Michigan's 83 counties.

B. Description Of MPSC Proceedings And Opinions And Orders On Appeal.

1. Proceedings For Detroit Edison's And Consumers Energy's Codes of Conduct.

Beginning in 1997, the MPSC issued a series of orders establishing the rates, terms and conditions of electric retail open access programs. After this Court held in 1999,[3] that the MPSC lacked statutory authority to compel electric utilities to provide retail open access service, Detroit Edison and Consumers Energy worked with the Commission to establish voluntary retail open access programs. In 1999, the MPSC approved individuals codes of conduct for Detroit Edison and Consumers Energy. The codes were allegedly designed to ensure that the utilities'

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[2] MECA's membership consists of the following cooperatives: (1) Alger Delta Cooperative Electric Association (located in the central upper peninsula); (2) Cherryland Electric Cooperative (located in the northwestern region of the lower peninsula); (3) Cloverland Electric Cooperative (located in the eastern upper peninsula); (4) Great Lakes Energy Cooperative (located in the north central and western regions of the lower peninsula); (5) Home Works Tri-County Electric Cooperative (located in central Michigan); (6) Midwest Energy Cooperative (located in southern Michigan); (7) The Ontonagon County Rural Electrification Association (located in the northwestern upper peninsula); (8) Presque Isle Electric & Gas Co-Op (located in the northeastern lower peninsula); (9) Thumb Electric Cooperative (located in the thumb area of lower Michigan) and (10) Wolverine Power Supply Cooperative, Inc. (based in Cadillac, Michigan). Wolverine is a wholesale power supplier regulated by the Federal Energy Regulatory Commission. MECA's other nine members (retail) are regulated by the MPSC.

[3] *Consumers Power Co v Public Service Comm*, 460 Mich 148, 596 NW2d 126 (1999).

unregulated alternative electric suppliers did not receive preferential treatment in the retail open access programs.

On September 14, 1999, the MPSC issued a *sua sponte* order commencing Case No. U-12134 for the purpose of considering both Detroit Edison's and Consumers Energy's individual codes of conduct. (September 1999 Order, Appellants' Joint Appendix at 47a – 50a). In that Order, the Commission stated:

> The Commission has approved provisional codes of conduct for Consumers and Detroit Edison, but the informal meetings designed to develop a permanent code have proved unavailing and there appears to be little prospect for consensus to be reached. Accordingly, the Commission concludes that a contested case proceedings should be initiated for the purpose of determining what modifications, if any, should be made to the existing codes of conduct. *Id.* at 3, Appendix at 49a.

The case was partially completed when Act 141 took effect on June 5, 2000.

2. Act 141's Directive.

Subsection 10a(4) of Act 141 directed the MPSC, within 180 days (*i.e.,* no later than December 4, 2000), to establish a code of conduct for all electric utilities regulated by the MPSC. Subsection 10a(4) provides, in pertinent part:

> Within 180 days after the effective date of the amendatory act that added this section, the commission shall establish a code of conduct that shall apply to all electric utilities. The code of conduct shall include, but is not limited to, measures to prevent cross-subsidization, information sharing, and preferential treatment, between a utility's regulated and unregulated services, whether those services are provided by the utility or the utility's affiliated entities.

The statute did not specify the manner in which the MPSC was to establish the code of conduct.

3. The MPSC Uses The Existing Contested Case Proceeding To Create An Industry-Wide Code Of Conduct.

Subsequent to Act 141's enactment, the MPSC used the existing Consumers Energy/Detroit Edison contested case, Case No. U-12134, to meet its statutory obligation and establish a code of conduct applicable to all utilities. Notably, the MPSC did not require the joinder of all electric utilities to which the code of conduct was to apply as parties to the case, and chose instead to permit such utilities to intervene in the case on an *ad hoc* basis.

a. The December 2000 MPSC Order.

On December 4, 2000, the MPSC issued an order ("December 2000 Order") adopting a code of conduct. (December 2000 Order, Appellants' Joint Appendix at 56a – 81a). The code of conduct, among other things, required industry members to (i) relocate facilities, equipment and employees; (ii) overhaul sales, marketing and promotional activities; (iii) re-evaluate and reformulate financings; and (iv) revise internal procedures. The code of conduct also required each regulated electric utility to file a code of conduct compliance plan within 90 days from the December 2000 Order's date. In response to the December 2000 Order, MECA filed a motion for rehearing, reconsideration and reclarification on January 3, 2001. MECA also joined Consumers Energy and Detroit Edison in filing a joint statement of statutory interpretation and request for immediate interim revision to § VI of the code of conduct. The joint request also sought a filing deadline extension for the code of conduct compliance plans. The parties also requested that the MPSC stay the code of conduct's enforcement pending appeal.

On January 23, 2001, the MPSC issued an order granting, in part, the request for immediate interim relief. (January 2001 Order, Appellants' Joint Appendix at 82a – 85a). The January 23, 2001 Order also revised the code of conduct so that each electric utility's compliance plan would be due within 60 days following the issuance of the MPSC's order on rehearing,

reconsideration and clarification. The MPSC's January 23, 2001 Order did not address the utilities' request that enforcement of the code of conduct be stayed pending appeal.

b. The October 2001 MPSC Order.

On October 29, 2001, after considering the numerous petitions for rehearing, reconsideration and clarification, the MPSC issued an order ("October 2001 Order") which, among other things, denied the January 3, 2001 request for stay. (October 2001 Order, Appellants' Joint Appendix at 89a – 113a). The MPSC also ordered all electric utilities and alternative electric suppliers, even those that were not direct parties to the case, to file a compliance plan within 60 days of the order on rehearing, *i.e.*, no later than December 29, 2001. The filing utility could request a waiver from one or more provisions of the code. A waiver would only be granted, however, if the electric utility could demonstrate that the requested waiver "will not inhibit the development or functioning of the competitive market." *Id.*

c. The October 2002 MPSC Order.

On December 28, 2001, Detroit Edison, Consumers Energy, and each of MECA's member-cooperatives filed a compliance plan and waiver request with the MPSC. On October 3, 2002, the MPSC issued its orders for Consumers Energy, MECA and Detroit Edison accepting the parties' compliance filings and denying in part each party's waiver requests. (October 2002 Orders, Appellants' Joint Appendix at 121a – 181a). With respect to both Consumers Energy and MECA's member-cooperatives, some of the waivers were conditioned upon the adherence to "guidelines" previously adopted by the MPSC in a completely different docket that, *inter alia*, required utilities to provide access to company and affiliate records to the MPSC, prohibited cross-subsidization of non-utility activities, required prior notification of the MPSC for transfers of utility assets to non-utility affiliates, and required certain reporting of assets and credit

arrangements. *See In re Public Service Commission Guidelines for Transactions Between Affiliates*, 252 Mich App 254, 259-261; 652 NW2d 1 (2002) ("*Affiliate Transactions Guidelines*"). Less than three months earlier, the Court of Appeals had determined that these "guidelines" were unlawfully adopted in violation of the rulemaking procedures of the APA. *Id.* at 262-268. Thus, the MPSC's October 2002 order tied the granting of waivers to adherence to guidelines in another docket – which guidelines the Court of Appeals had found to be unlawfully adopted.

C. Court of Appeals Proceedings.

1. Appellate Proceedings Relating To The December 2000 And October 2001 Orders.

On November 20, 2001, Detroit Edison, Consumers Energy and MECA each filed a claim of appeal challenging the MPSC's December 2000 and October 2001 Orders. The Court of Appeals consolidated the three dockets (Court of Appeals Docket Nos. 237872, 237873 and 237874). On March 2, 2004, the Court of Appeals affirmed the MPSC's December 2000 and October 2001 Orders. (Court of Appeals Opinion, Appellants' Joint Appendix at 227a – 242a).

In affirming the MPSC's Opinion and Orders, the Court of Appeals found that the code of conduct "falls within the APA's definition of a rule because it establishes substantive standards of general applicability that have the force and effect of law." (Court of Appeals Opinion, Appellants' Joint Appendix at 236a). The Court of Appeals found, however, that "the code of conduct is not a rule because it was implemented via orders entered in a contested case." *Id.* In reaching this conclusion, the Court of Appeals failed to determine whether it was proper for the MPSC to have enacted the code of conduct in a contested case proceeding (which it is not) and also failed to discuss or distinguish the holding of *Affiliate Transactions Guidelines*,

instead citing it only once without any explanation. It is this March 2, 2004 decision that is the subject of this appeal.

2. Appellate Proceedings Related To The October 2002 Order.

Because the code of conduct as applied in the MPSC's October 2002 Order which denied, in part, each utility's waiver requests, remains unlawful and unreasonable, MECA and Consumers Energy filed an independent claim of appeal with the Court of Appeals on October 18, 2002. On August 17, 2004, the Court of Appeals affirmed the MPSC's October 2002 Order. In reaching its decision, the Court of Appeals relied heavily on the law of the case doctrine, and found that its previous decision in this case required it to conclude that the MPSC had acted properly in creating the code of conduct as part of a contested case proceeding. *Id.* The Court of Appeals failed to meaningfully address, however, the impact of the *Affiliate Transactions Guidelines* decision on its decision in this case. The Court of Appeals' August 17, 2004 decision is the subject of separate Applications for Leave to Appeal that are pending with this Court.

D. Public Reaction To And Continued Enforcement Of The MPSC's Orders.

The MPSC's docket in Case Number U-12134 did not close after the MPSC issued its December 2000 and October 2001 orders. In fact, the docket has more than doubled in the number of entries recorded since that time, reaching over 300 total entries.[4] (MPSC Docket, Appellants' Joint Appendix at 1a – 14a).

As the MPSC's docket sheet demonstrates, the MPSC received an extraordinary number of comments from the public and affected members of the business community in response to the

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[4] While docket entries made after this case was originally sent to the Court of Appeals are not a part of the record below, MECA respectfully requests that this Court take judicial notice of those entries and the substantive documents that they represent. Taking judicial notice of these items is proper since Michigan courts are free to take judicial notice of agency actions taken during the pendency of an appeal. *See Grandville Municipal Executive Ass'n v City of Grandville*, 453 Mich 428, 442; 553 NW2d 917 (1996); *see also* MRE 201.

code of conduct and the MPSC's decisions in the various waiver request matters, and particularly with respect to Consumers Energy's Appliance Service Program. (MPSC Docket Nos. 210-224, 226, 227, 229, 230, 233, 235-237, 244, 268, and 275, Appellants' Joint Appendix at 1a – 6a). A representative sample of these letters and comments is provided in the Appendix. (Public Comments, Appellants' Joint Appendix at 182a – 198a). The code of conduct and electric utilities' compliance with the code of conduct also have been the subject of several complaints filed by individuals and competitors alleging violations of the code of conduct by electric utilities. (MPSC Docket Nos. 281, 261, 174, 119, Attached in full in the Appellants' Joint Appendix at 206a – 211a, 199a – 205a, 114a – 120a, 86a – 88a). Some of these complaints were later prosecuted as contested case proceedings against the electric utility in which the MPSC imposed fines against the utility for violation of the code of conduct, as set forth in U-12134. *See, e.g.*, MPSC Case No. U-13830, September 21, 2004 Order, Appellants' Joint Appendix at 212a – 226a.

STANDARDS OF REVIEW

To prevail on appeal, an appellant must show by "clear and satisfactory evidence" that the MPSC order complained of is "unlawful or unreasonable." MCL 462.26(8); *Michigan Consolidated Gas Co v Pub Serv Comm*, 389 Mich 624, 635-36; 209 NW2d 210 (1973). An MPSC order is unlawful if it is based on an erroneous interpretation or application of the law, and, in cases where a hearing is required, is unreasonable if it is not supported by competent, material, and substantial evidence on the whole record. Const 1963, art 6, § 28; *Associated Truck Lines Inc v Pub Serv Comm*, 377 Mich 259, 279; 140 NW2d 515 (1966).

Questions of statutory interpretation, including whether the MPSC exceeded the scope of its statutory authority, are reviewed *de novo*. *Consumers Power Co v Pub Serv Comm*, 460 Mich 148, 157; 596 NW2d 126 (1999); *In re MCI Telecommunications Complaint*, 460 Mich 396, 413; 596 NW2d 164 (1999); *TCG Detroit v City of Dearborn*, 261 Mich App 69, 98; 680 NW2d 24 (2004). The question of whether an agency policy is invalid because it was not promulgated as a rule under the APA is also reviewed *de novo* as a question of law. *Faircloth v FIA*, 232 Mich App 391, 401; 591 NW2d 314 (1998); *Affiliate Transactions Guidelines*, *supra*, 252 Mich App at 263.

ARGUMENT

I. THE DECEMBER 2000 AND OCTOBER 2001 ORDERS ARE UNLAWFUL BECAUSE THEY ADOPT RULES THAT WERE NOT PROMULGATED IN ACCORDANCE WITH THE APA'S RULEMAKING PROCEDURES, AND NO EXCEPTIONS TO THOSE PROCEDURES APPLY.

A. The Code of Conduct Should Have Been Promulgated As A Rule Since It Has Prospective, General Applicability.

Section 7 of the APA, MCL 24.207, defines the term "rule" as "an agency regulation, statement, standard, policy, ruling, or instruction of general applicability that implements or applies law enforced or administered by the agency, including the amendment, suspension, or rescission of the law enforced or administered by the agency." The definition also contains several exceptions, one of which states that a rule does not include "[a] determination, decision, or order in a contested case." MCL 24.207(f).

1. MPSC Case Number U-12134 Does Not Fit The Definition Of A Contested Case Under The APA, And Therefore Does Not Qualify For An Exception From The General Rulemaking Requirements.

In its March 2, 2004 decision, the Court of Appeals held that the code of conduct was not a "rule" as defined by the APA "because it was implemented via orders entered in a contested case." (Court of Appeals Opinion, Appellants' Joint Appendix at 237a). In determining that this exception applied to the code of conduct, the Court of Appeals stated only the following:

> These proceedings were conducted as a contested case in that the order commencing the matter listed [Detroit Edison] and [Consumers Energy] as parties and provided them and the intervening parties with the opportunity for a hearing as required by MCL 24.203(3). The [MPSC's] renoticing of the proceedings for the purpose of complying with MCL 460.10a(4) and implementing a code of conduct applicable to all electric utilities and having the force and effect of law does not change the dynamic of a contested case. (Court of Appeals Opinion, Appellants' Joint Appendix at 237a-238a).

In reaching this conclusion, however, the Court of Appeals failed to evaluate whether the MPSC proceedings continued to maintain the character of a true "contested case" when the MPSC expanded the Detroit Edison/Consumers Energy proceedings for the purpose of creating a universally applicable code of conduct.

The APA defines a "contested case" as "a proceeding, including rate-making, price-fixing, and licensing, in which a determination of the legal rights, duties, or privileges of a named party is required by law to be made by an agency after an opportunity for an evidentiary hearing." MCL 24.203(3) (emphasis added). This definition conforms with the general administrative law hornbook understanding of a contested case, also called an "adjudication," as "a determination of individual rights or duties" and "the decisionmaking process for applying preexisting standards to individual circumstances." 1 Koch, Administrative Law and Practice (2d ed), § 2.11 (emphasis added). In this case, however, the MPSC attempts to use the contested case proceeding as a vehicle not to determine the legal rights, duties or privileges of a specific, named party, but to improperly set forth a new set of regulatory standards applicable to the *entire industry*. As the Court of Appeals previously found in the *Affiliate Transactions Guidelines* case, however, a contested case proceeding is an improper vehicle for the creation of standards of general applicability.

In *Affiliate Transactions Guidelines,* a decision that was issued a mere 17 months before the Court of Appeals decided this case, the Court of Appeals ruled that the affiliate transaction guidelines created by the MPSC were unlawful because the proceeding in which they were adopted was not properly initiated by the MPSC as a "contested case," and APA rulemaking procedures therefore applied. In the *Affiliate Transactions Guidelines* case, the MPSC had been concerned about the cross-subsidization of utilities and their affiliates. It thus issued a series of

orders that contained "affiliate transaction guidelines" regarding transactions between regulated electric or natural gas utilities and their nonregulated holding companies, subsidiaries, and affiliates. After the Court of Appeals held that the MPSC lacked authority to impose certain accounting and bookkeeping methods on the utilities, the MPSC *sua sponte* issued an order and notice of hearing of a contested case proceeding to consider changes to the guidelines. Several parties intervened in the case and, following a hearing and proposal for decision, the MPSC issued its opinion and order adopting revised guidelines. Subsequently, the utilities and an industry association appealed the MPSC order on the basis that the guidelines were invalid because they were adopted by order in a contested case proceeding rather than by the APA's rulemaking procedures.

In deciding that the contested proceeding was not a proper method for enacting the guidelines, the Court of Appeals first determined that the proceeding failed to qualify as a "contested case" because it only tangentially involved ratemaking and was neither a rate case nor an investigation of rates. *Id.* at 266. The Court of Appeals also found that the proceeding was "wholly incompatible with the definition of a 'contested case' under the APA" because the MPSC's order initiating the contested case did not list any named parties, but directed interested persons to intervene. *Id.* As the Court of Appeals noted: "Thus, because 'the legal rights, duties, or privileges of a named party' were not determined, the proceeding was not a contested case." *Id.* at 267. In addition to the fact that the proceeding was initiated by the MPSC against unnamed entities, the proceeding was initiated with the express intent to review and revise regulatory standards that would have general and prospective application. In contrast, a contested case typically involves an individually named party, a disputed set of facts, and the

adjudication of a specific factual dispute that operates retroactively to bind the agency and the named party. *Id.* at 267. In vacating the affiliate guideline order, the Court of Appeals stated:

> Invoking the public interest and the need for policy that is responsive to a changing industry, the PSC eschewed the procedural mandates of the APA in favor of its own course of action. By choosing to implement 'guidelines' by order in a contested case against unnamed parties, yet with the force and effect of law, the PSC culled elements of rulemaking, adjudication, and general policy formation, with little regard for the dictates of the APA. While we do not doubt the PSC's legitimate concerns of lack of access to the accounts and records of a utility's nonregulated affiliates and subsidiaries, and the potential for 'cross-subsidization of nonutility investments through utility rates' . . . the process utilized by the PSC constituted a rather heavy-handed rebuke of established APA procedures, and, accordingly, we are compelled to invalidate that process. *Affiliate Transactions Guidelines, supra* at 267-268.

The *Affiliate Transactions Guidelines* case is directly on point. First, similar to the guideline proceeding found unlawful in *Affiliate Transactions Guidelines*, this code of conduct proceeding had nothing to do with the review or setting of rates for individual utilities. Second, the contested case was first initiated "to consider modifications to the provisional codes of conduct approved for Consumers Energy Company and The Detroit Edison Company in the context of restructuring the electric utility industry." (MPSC June 19, 2000 Opinion and Order, Appellants' Joint Appendix at 51a). After Act 141 was adopted, however, the case was expanded so that a code of conduct could be adapted to apply to the industry in its entirety. While the case's caption is *In the matter of the approval of a code of conduct for Consumers Power Company and The Detroit Edison Company*, which makes it appear as if the proceeding had to do with individually named parties or the adjudication of disputed facts, the case actually affects all of Michigan's utilities and alternative electric suppliers.[5] As in the *Affiliate*

[5] The case caption is particularly relevant since this caption was used in all Notices of Hearings and Orders

Transaction Guidelines proceeding, the MPSC here attempts to create a set of standards applicable to the industry as a whole, thus failing to fit within the definition of a "contested case." Finally, while a contested case normally applies the law to past actions of a regulated entity, this case was for the purpose of adopting standards that would have prospective application to the industry. The case thus was an improper use of the contested case proceeding mechanism.

2. The Code Of Conduct Meets The Definition Of A Rule.

Since the code of conduct clearly should not have been created as a part of a contested case proceeding, it should have been promulgated as a rule. As indicated *supra*, the APA defines a "rule" as "an agency regulation, statement, standard, policy, ruling, or instruction of general applicability that implements or applies law enforced or administered by the agency, including the amendment, suspension, or rescission of the law enforced or administered by the agency." MCL 24.207. This definition reflects the generally accepted understanding of rulemaking as "a determination of general applicability and predominately prospective effect." 1 Koch, Administrative Law and Practice (2d ed), § 2.11. In fact, rulemaking is "described in terms of three key indicators: generalized nature, policy orientation, and a prospective applicability." *Id.* Moreover, "[s]tate courts will generally require an agency to follow rulemaking procedures when they formulate a policy to guide future agency action or to guide the conduct of a class, especially if the policy has an impact on the rights of the public." *Id.* § 4.17. *See also Danse Corp v City of Madison Heights*, 466 Mich 175, 181; 644 NW2d 721 (2002) ("In order for an agency regulation, statement, standard, policy, ruling, or instruction of general applicability to

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issued in this case. There was no hint in these captions that industry-wide codes of conduct would be developed in these proceedings, and the public had no meaningful opportunity to participate in them. (MPSC Docket No. 9, Appellants' Joint Appendix at 14a).

have the force of law, it must fall under the definition of a properly promulgated rule."). As is demonstrated by the numerous filings in the MPSC's docket after the MPSC issued its orders creating the code of conduct, the decisions made in U-12134 clearly have prospective applicability. Regulated utilities have been required to file compliance reports regarding their adherence to the code of conduct, and must continually monitor this docket to ensure that the MPSC's policies as expressed in the code of conduct are not changed. (MPSC Docket, Appellants' Joint Appendix at 1a – 14a). This type of ongoing proceeding demonstrates that the MPSC should have proceeded by rule instead of by contested case.

This Court has repeatedly held that the preferred method of state administrative policymaking is by rule promulgation. *American Federation of State, County and Municipal Employees, AFL-CIO v Dep't of Mental Health* ("*AFSCME*"), 452 Mich 1, 9; 550 NW2d 190 (1996). As explained by Justice Riley in her partial concurrence and dissent in *Clonlara Inc v State Board of Education*, 424 Mich 230, 255-256; 501 NW2d 88 (1993):

> In Michigan, the exercise of legislative authority duly delegated to administrative agencies is referred to as rule making, and the APA prohibits rule making without undergoing strict public scrutiny through "public hearings, public participation, notice, approval by the joint committee on administrative rules, and preparation of statements, with intervals between each process." The extensive notice and hearing procedures mandated by the APA are "'calculated to invite public participation in the rule-making process, prevent precipitous action by the agency, prevent the adoption of rules that are illegal or that may be beyond the legislative intent, notify affected and interested persons of the existence of the rules, and make the rules readily accessible after adoption.'" More important, the APA is essential to the preservation of a democratic society. Put simply, without public oversight and scrutiny of legislative action undertaken by administrative agencies, such agencies would rule without the normal safeguards of our republic. Indeed, the APA is a bulwark of liberty by ensuring that the law is promulgated by persons accountable directly to the people. (citations omitted.)

In order to reflect the preference for policy determinations pursuant to rules, the definition of "rule" is to be broadly construed, while the exceptions are to be narrowly construed. *AFSCME*, *supra* at 9. This preference for rulemaking exists because of the procedural protections that are inherent in the processes set forth in Chapter 3 of the APA, MCL 24.231 to 24.264, and described by Justice Riley in her opinion in *Clonlara*. These protections are especially important because of the far-reaching consequences which administrative rules often carry. As such, rules which do not comply with the APA's procedural requirements are invalid. *See Goins v Jeep Eagle, Inc*, 449 Mich 1, 10; 534 NW2d 467 (1995).

As this Court also has repeatedly held, "the label an agency gives to a directive is not determinative" of its status pursuant to the APA. *AFSCME*, *supra* at 9. Instead, the court "must review the 'actual action undertaken by the directive, to see whether the policy being implemented has the effect of being a rule.'" *Id.* (quoting *Detroit Base Coalition for the Human Rights of the Handicapped v Dep't of Social Services* ("*Detroit Base Coalition*"), 431 Mich 172, 188; 428 NW2d 335 (1988)). Moreover, rules "must be promulgated in accordance with the procedures set forth in the APA, and are not valid if those procedures are not followed." *Clonlara Inc*, *supra* at 239.

In *AFSCME*, this Court was asked to determine "whether the guidelines and standard contract utilized by the Department of Mental Health when contracting with group home providers for the purchase of specialized residential mental health services constitute administrative 'rules' that must be promulgated pursuant to the [APA]." *AFSCME*, *supra* at 3. The Court answered this question in the affirmative, finding that the guidelines and the standard contract did constitute "rules" that should have been promulgated as such pursuant to the APA. The Court based its conclusion on a number of factors, including that (1) "many of the contract's

provisions set forth departmental policy and standards that have a direct effect on the care provided in group homes," *Id.* at 8; (2) "the guidelines and contract provisions implement and apply the Mental Health Code's requirement that the department provide mental health services appropriate to the public's needs and prescribe the department's procedure relevant to those services," *Id.* at 9; (3) the guidelines and contract provisions "have direct applicability to all those who reside and work in these homes," *Id.*; and (4) the provisions in the guidelines and standard contract are binding on contractors and are not subject to negotiation. *Id.* at 9-11. Since the guidelines and contract thus constituted "rules" that had not been promulgated pursuant to the APA's rulemaking procedures, the Court determined that they had been improperly created and remanded the case for consideration of an appropriate remedy. *Id.* at 15.

Similarly, in *Detroit Base Coalition*, this Court found that a telephone hearing policy created by the Department of Social Services ("DSS") violated the rulemaking requirements of the APA since it modified the manner in which hearings were conducted, in contradiction of then-current DSS rules. In reaching this decision, the Court noted that "the adoption of a rule by an agency has the force and effect of law and may have serious consequences of law for many people," and, as such, the rulemaking process "requires public hearings, public participation, notice, approval by the joint committee on administrative rules, and preparation of statements, with intervals between each process." *Id.* at 177-178. The Court also noted that the rulemaking procedures are important because:

> [I]n recent years, legislative bodies have delegated to administrative agencies increasing authority to make public policy and, consequently, have recognized a need to "ensure that none of the essential functions of the legislative process are lost in the course of the performance by agencies of many law-making functions once performed by our legislatures." Bonfield, State Administrative Rule Making, § 1.1.1, p 4. Thus, the question whether the policy may be adopted without compliance with the

> APA is more than a question of notice and hearing requirements. It is a question of the allocation of decision-making authority. *Id.* at 178 (emphasis added).

Finally, the Court asserted that "[w]hen action taken by an agency alters the status quo, those who will be affected by its future application should have the opportunity to be heard and to participate in the decisionmaking." *Id.* at 185 (citing *Metromedia Inc v Taxation Div*, 97 NJ 313; 478 A2d 742 (1984)). Given these considerations, the Court found that DSS' modification of its hearing procedures should have been accomplished by rule. Since it was not, the Court prohibited DSS from implementing it. *Id.* at 190.

Additionally, in *Kent County Aeronautics Board v Dep't of State Police*, 239 Mich App 563; 609 NW2d 593 (2000), the Michigan Court of Appeals was asked to determine whether "equivalent site criteria" created by the State Police to select the location of a communications tower were rules subject to the rule-making requirements of the APA. In evaluating this issue, the court looked to the following factors: (1) whether the "rule" affects the rights of the public; (2) whether the "rule" creates legal obligations for entities or persons other than the agency itself; (3) whether the "rule" has the force and effect of law and requires compliance with any stipulations or requirements; and (4) whether the "rule" imposes sanctions for failure to follow its provisions. *Id.* at 583. While the court answered each of these questions in the negative with respect to the policy at issue, the factors used in evaluating whether that policy constituted a "rule" pursuant to the APA are instructive in evaluating the code of conduct at issue in this case. *Id.*

Courts in several other states have applied similar factors and created corresponding tests to help them determine whether an administrative action constitutes a rule such that state administrative rulemaking procedures must be followed. These cases are consistent with Michigan case law and provide additional guidance in determining whether an agency action

constitutes a "rule" which must be promulgated pursuant to formal rulemaking procedures. One often-cited case is the New Jersey decision of *Metromedia Inc v Taxation Div*, 97 NJ 313; 478 A2d 742 (1984), in which the court enumerated a six factor test to be used in evaluating whether agency action constitutes rulemaking. This test is used to elaborate upon the definition of a "rule" in the New Jersey Administrative Procedures Act, which, like the Michigan definition, describes a "rule" as "each agency statement of general applicability and continuing effect that implements or interprets law or policy, or describes the organization, procedure or practice requirements of any agency." NJSA 52:14B-2(e).[6] In applying this definition, the *Metromedia* court stated:

> [A]n agency determination must be considered an administrative rule when all or most of the relevant features of administrative rules are present and preponderate in favor of the rule-making process. Such a conclusion would be warranted if it appears that the agency determination, in many or most of the following circumstances, (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group; (2) is intended to be applied generally and uniformly to all similarly situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule, or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter; and (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy. These relevant factors can, either singly or in combination, determine in a given case whether the essential agency action must be rendered through rule-making or adjudication. *Id.* at 331-332.

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[6] Like the Michigan definition of an administrative rule, the New Jersey definition also exempts "agency decisions and findings in contested cases." NJSA 52:14B-2(e).

More recent New Jersey decisions have applied these *Metromedia* factors but also have noted that "not all of these factors must be present for an agency action to constitute rulemaking; instead the factors are balanced according to weight." *Coalition for Quality Health Care v New Jersey Dep't of Banking and Ins*, 348 NJ Super 272, 296; 791 A2d 1085 (2002).

Courts in other states, such as Tennessee and Idaho, have adopted the *Metromedia* factors in determining "when rulemaking rather than adjudicatory proceedings are required." *See Tennessee Cable Television Ass'n v Tennessee Public Service Comm*, 844 SW2d 151, 162-163 (Tenn Ct App 1992); *Asarco Inc v State*, 138 Idaho 719, 723; 69 P3d 139 (2003). Other states have adopted more abbreviated tests that focus on certain parts of the *Metromedia* test. *See, e.g., Dep't of Revenue v Vanjaria Enterprises Inc*, 675 So 2d 252, 255 (Fla 1996) (finding that "[a]n agency statement that either requires compliance, creates certain rights while adversely affecting others, or otherwise has the direct and consistent effect of law is a rule"), *Failor's Pharmacy v Dep't of Social and Health Services* (en banc), 125 Wash 2d 488, 495; 886 P2d 147 (1994) (finding that an action "is of general applicability," and thus is a rule, "if applied uniformly to all members of a class"), and *NME Hospitals Inc v Dep't of Social Services* (en banc), 850 SW2d 71, 74 (Mo 1993) (stating that "[a]n agency standard is a 'rule' if it announces '[a]n agency statement of policy or interpretation of law of future effect which acts on unnamed and unspecified facts....'") (citations omitted).

Based upon the evaluation criteria used by both the courts of this State and the courts of other states, the substance of which is essentially the same, the code of conduct clearly qualifies as a rule. First, the code of conduct indisputably establishes standards of "general applicability," since it affects the general public and creates legal obligations for all electric utilities and alternative energy suppliers. The code of conduct itself unambiguously states that it applies to

"*all* electric utilities as defined by MCL 460.562 and to alternative electric suppliers, as defined by MCL 460.10g, who, together with their affiliates, provide regulated services in Michigan and unregulated services." (October 2001 Order, Appellants' Joint Appendix at 108a, Exhibit A to Order, p 1, § I) (emphasis added). This is precisely the same as in *AFSCME*, supra, wherein this Court concluded that a "rule" existed where guidelines and a standard contract utilized by the Department of Mental Health applied to all persons who resided and worked in group homes. The code of conduct also clearly operates prospectively by requiring continuing compliance and reporting by the utilities and alternative electric suppliers.

As shown by its penalty provisions, the code of conduct also establishes standards which have the force and effect of law. *See Clonlara*, *supra* at 240 (quoting Bienenfeld, Michigan Administrative Law (2d ed), ch 4, p 18 ("'Legislative rules are substantive rules that have the force and effect of law. These rules fill in the interstices of the statute and presumably carry out its intent in greater detail.'")); s*ee also Faircloth v FIA*, 232 Mich App 391, 404; 591 NW2d 314 (1998) (explaining that a policy that establishes substantive standards is a rule). The code of conduct contains a section entitled "Oversight, Enforcement, and Penalties." (October 2001 Order, Appellants' Joint Appendix at 113a, Exhibit A to Order, p 6, Section VII). This section requires the utilities to (1) maintain documentation needed to investigate compliance with the code; (2) make the information available to the MPSC or Staff upon request; (3) designate an officer or personnel who can respond to the MPSC or its Staff regarding compliance; (4) develop a documented dispute resolution process, separate and distinct from the MPSC's process, to address customer complaints; and (5) file annual reports with the MPSC summarizing the number and types of complaints received, and their resolution. *Id.* at Section VII, (A)-(C). Clearly, these requirements constitute standards having the force and effect of law.

The code of conduct also imposes sanctions for noncompliance because it states that: "[p]enalties for violations of the code of conduct will be as provided in Section 10c of the Customer Choice and Electricity Reliability Act, MCL 460.10c." *Id.* at Section VII, (D). Under Section 10c, the penalties for non-compliance with any Act 141 section include fines, refunds, attorneys fees, revoked licenses, and cease and desist orders. MCL 460.10c. Sanctions for violations of the code of conduct already have been applied in at least one case, where fines and costs of over $47,000 were imposed on Consumers Energy for including an insert regarding its affiliate service program with customer billing statements. The MPSC also issued a cease and desist order enjoining further violations of the code of conduct and related MPSC orders. *See* MPSC Case No. U-13830, September 21, 2004 Order, Appellants' Joint Appendix at 212a – 226a. A similar case has been commenced against Detroit Edison. *See* MPSC Case No. U-14072, *available at* http://efile.mpsc.cis.state.mi.us/cgibin/efile/viewcase.pl?casenum=14072&submit.x=33&submit.y=6.

Whatever test for administrative rulemaking is applied, the code of conduct satisfies it. The MPSC thus acted improperly when it attempted to create the code of conduct via a "contested case" proceeding, instead of by rulemaking. As a result, this Court should find that the code of conduct is invalid.

B. This Court Should Follow The Decision Of The Maryland Court Of Appeals In *Delmarva Power & Light Co v Public Service Comm of Maryland*, And Find That The MPSC Should Have Implemented The Code Of Conduct By Rule.

In *Delmarva Power & Light Co v Public Service Comm of Maryland*, 370 Md 1; 803 A2d 460 (2002), the Maryland Court of Appeals held that a code of conduct that implemented the restructuring and partial deregulation of electric and gas utilities contained regulations that had to be promulgated pursuant to that state's administrative procedures act in order to be valid. This

Court should follow the holdings of the *Delmarva Power & Light Co* case, which is nearly factually and legally identical to the case at bar.

In the mid-1990s, Maryland's gas and electric utilities "had already begun to diversify their business operations and, through subsidiaries formed for the purpose, move into areas and endeavors that were not intimately related to their core utility services." *Id.* at 10. At first, the Maryland Public Service Commission addressed "[s]ome of the issues raised by diversification activities" in "company specific proceedings." *Id.* Seeking broader application of standards, the Maryland Public Service Commission opened a generic case proceeding to investigate "affiliate transactions of all Maryland gas and electric utilities." *Id.* at 13. As a result of this proceeding, "the Commission adopted fourteen standards of conduct that would apply to all electric and gas utilities in transactions with their core-service affiliates and four standards of conduct that would apply in transactions with non-core-service affiliates." *Id.* at 14. Like this case, the Maryland Commission's "various decisions, including the standards of conduct, became applicable to the gas and electric utilities solely by virtue of their inclusion in the Commission's [Order]. No attempt was made to embody them in regulations." *Id.* at 15.

Then, in 1999 and 2000, the Maryland Legislature enacted the Electric Customer Choice and Competition Act of 1999 and the Natural Gas Supplier Licensing and Consumer Protection Act of 2000. *Id.* Among other things, these acts required the Maryland Commission to create a code of conduct between companies and their affiliates. *Id.* at 16. Following enactment of the Electric Act, the Maryland Commission initiated Case No. 8820 as a generic proceeding. *Id.* at 17. As a result of these proceedings, the Commission "ultimately adopted seven standards of

conduct to govern transactions between utilities and any of their affiliates and seven additional standards of conduct to govern transactions with core-service affiliates."[7] *Id.*

The Commission's order was challenged as invalid because it had not complied with "the statutory requirements for the adoption of a regulation." *Id.* The Maryland Court of Appeals found that the code of conduct qualified as a "rule," and thus was invalid since it had not been adopted pursuant to the Maryland rulemaking procedures. *Id.* at 26. This finding was based on the Maryland court's observations that, "[w]ith limited exception," the provisions of the code of conduct "have general application to all electric and gas utilities and their various affiliates; they have future effect; they were adopted by a 'unit' – the PSC – to carry out laws that the PSC administers; they were in the form of statements of policy; and they fall within none of the exceptions" listed in the statute. *Id.* The Maryland court went on to state that, while generally an agency has a choice between policymaking by adjudication or by rule, **when an agency chooses to adopt a policy to be applied "across-the-board," instead of on a "case-specific" basis, it must act by rule**. *Id.* at 34-38.

In *Delmarva Power & Light Co*, the Maryland Public Service Commission attempted to act by a generic proceeding where it should have acted by rule. Similarly, in this case, the

[7] The seven standards applicable to transactions between utilities and affiliates generally prohibited the following: (1) representing that a customer will receive an advantage with respect to his or her utility service as a result of dealing with a utility's affiliate; (2) representing that an affiliate is the same company as the utility or that its rates are regulated; (3) creating joint marketing, promotions, or advertising between a utility and an affiliate; (4) tying the provision of a regulated utility service to another product or service; (5) giving a preference to an affiliate or its customers in providing regulated utility services; (6) disclosing certain customer-specific information without the customer's informed consent; and (7) offering discounts, rebates, or waivers only to affiliates or their customers. *Id.* at 18-19. The seven standards applicable to transactions between utilities and core-service affiliates ("CSAs") generally prohibited the following: (1) initiating an unsolicited joint sales call; (2) operating a utility and a CSA from the same location; (3) a utility providing sales leads to a CSA or speaking on behalf of a CSA; (4) highlighting or promoting a CSA over other service providers; (5) processing service requests differently for CSA and non-CSA entities; (6) providing special application of a tariff for delivery of energy services to CSA suppliers; and (7) failing to disclose information provided to an energy marketing affiliate and related to a utility's system, a utility's marketing or sale of energy to consumers, or a utility's delivery of energy to or on its system to non-affiliated suppliers. *Id.* at 19.

MPSC has improperly avoided rulemaking procedures, and attempts to bind all electric utilities and alternative electric suppliers, even those which may be created in the future, to a code of conduct that was not promulgated pursuant to the rulemaking provisions of the APA. The MPSC also is now enforcing its Order in U-12134 as it would enforce a regulation, and is issuing fines based on complaints filed by third parties. *See, e.g.*, MPSC Case No. U-13830, September 21, 2004 Order, Appellants' Joint Appendix at 212a – 226a. The MPSC thus is attempting to enforce the code of conduct as it would enforce a regulation. Since the code of conduct was not properly promulgated, however, it must be invalidated.

C. There Is No Evidence That The Michigan Legislature Intended To Excuse The MPSC From Its Rulemaking Obligations.

Finally, there is absolutely no evidence that the Michigan Legislature intended to excuse the MPSC from its rulemaking obligations in creating the code of conduct. Section 10a(4) of Act 141 states:

> Within 180 days after the effective date of the amendatory act that added this section, the commission shall establish a code of conduct that shall apply to all electric utilities. The code of conduct shall include, but is not limited to, measures to prevent cross-subsidization, information sharing, and preferential treatment, between a utility's regulated and unregulated services, whether those services are provided by the utility or the utility's affiliated entities. The code of conduct established under this subsection shall also be applicable to electric utilities and alternative electric suppliers consistent with section 10, this section, and sections 10b through 10bb.

In fact, unlike other provisions in the same section, § 10a(4) does not authorize the MPSC to "issue orders" for the code of conduct's establishment.

For example, §10a(1) provides in part: "[n]o later than January 1, 2002, the commission *shall issue orders* establishing the rates, terms and conditions of service that allow all retail customers of an electric utility or provider to choose an alternative electric supplier." MCL

460.10a(1)(emphasis added). Similarly, § 10a(2) states in pertinent part: "[t]he commission *shall issue orders* establishing a licensing procedure for all alternative electric suppliers." MCL 460.10a(2)(emphasis added). Finally, § 10a(3) provides that: "[t]he commission *shall issue orders* to ensure that customers in this state are not switched to another supplier or billed for any services without the customer's consent." MCL 460.10a(3).

If the Legislature had intended to authorize the MPSC to make policy through the issuance of orders rather than the preferred method of rulemaking, it certainly knew how to do so. The Legislature's failure to use the phrase "*shall issue orders*" in reference to the code of conduct demonstrates that it did not intend the MPSC to proceed by way of order. *See DiBenedetto v West Shore Hospital*, 461 Mich 394, 402; 605 NW2d 300 (2000) ("When reviewing questions of statutory construction, our purpose is to discern and give effect to the Legislature's intent. We begin by examining the plain language of the statute. Where that language is unambiguous, we presume that the Legislature intended the meaning clearly expressed – no further judicial construction is required or permitted, and the statute must be enforced as written."); *Farrington v Total Petroleum, Inc*, 442 Mich 201, 210; 501 NW2d 76 (1993) ("Courts cannot assume that the Legislature inadvertently omitted from one statute the language that it placed in another statute, and then, on the basis of that assumption, apply what is not there.")

Section 107 of the APA, MCL 24.207, defines a rule as a "regulation, statement, standard, policy, ruling, or instruction of general applicability." Since the MPSC attempts to create, via "contested case," a code of conduct that applies to all electric utilities and alternative energy suppliers, it violates the statutory requirement that all rules of general applicability be promulgated pursuant to the APA's rulemaking procedures. Consequently, the Court of

Appeals' March 2, 2004 decision and the MPSC Orders creating and implementing the code of conduct must be vacated.

CONCLUSION AND RELIEF REQUESTED

MECA respectfully requests that this Court reverse the Court of Appeals decision, the MPSC's December 4, 2000 and October 29, 2001 Orders and vacate the code of conduct.

Respectfully submitted,

MICHIGAN ELECTRIC COOPERATIVE ASSOCIATION and its distribution rural electric cooperatives,

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